NATIONAL FORECAST DESCRIPTION

The Forecast Period is the First Quarter of 2003 through the Fourth Quarter of 2006

This is a time of much worry for practitioners of the dismal science. The reputations of many economists will either be made or broken over the next six months. This is because many economists are betting the U.S. economy will shake off its current funk and start to show signs of faster growth. The economists of Global Insight are in this camp. Their current forecast shows the U.S. economy picking up steam during the second half of this year. Under their assumptions, next year promises to be the strongest of the forecast period, followed by slower growth in 2005 and 2006.

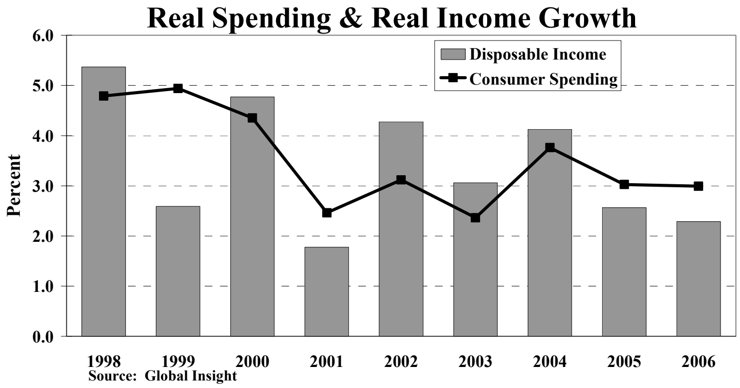
The National Bureau of Economic Research officially declared the 2001 recession ended in November 2001, eight months after it started. This would qualify it as one of the mildest recessions on record. Unfortunately, it seems no one told the employment sector the recession ended so long ago. From the recession's end to June 2003, the U.S. unemployment rate has increased from 5.6% to 6.4%--a nearly 100-basis point change. Another disturbing fact is uncertainty about when unemployment will peak. It was thought it would happen in the first half of this year at around 6.0%. But the current level of 6.4% has raised concerns that it may go higher. The near-term performance of the labor market will be a clear scorecard of how well economists have done their jobs. In the current forecast, U.S. nonfarm employment posts its first increase in the third quarter of 2003 after decreasing in the previous three quarters. On an annual basis it continues to increase through 2006. As a result, the unemployment rate drifts down slowly. However, it does not return to full-employment levels.

Another sector that seems to have missed the news about the recession's end is business investment. This has been an important omission, since this sector has been an important growth engine during the 1990s and earlier this decade. Strong business investment in the 1990s helped limit the severity of the 1990-91 recession. After that, heavy investment in equipment played a major role in making the last recovery the longest on record. But currently, it is suffering its most drawn out downturn among the 12 postwar recessions. However, it is anticipated to begin showing signs of life again during the second half of this year, and be in full recovery in 2004.

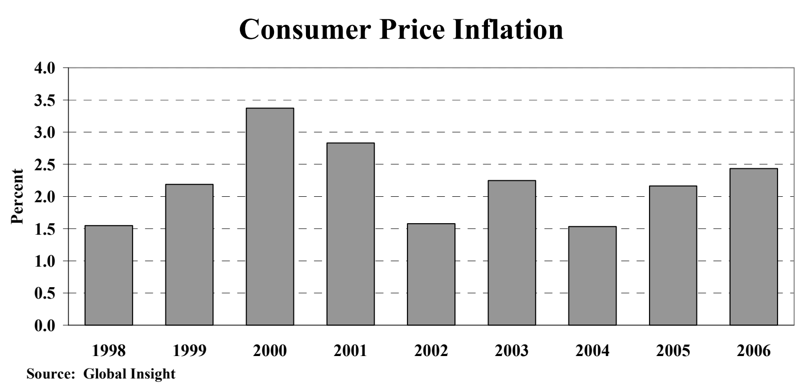
A major factor causing the optimism during the second half of this year is the economic stimulus already in the pipeline. Both the Federal Reserve and the federal government have taken actions to keep the economy moving. The nation's central bank lowered the federal funds rate to 1.0% in June, solidifying its commitment to bolster the economy. One of the reasons the Federal Reserve can affords to be so aggressive is the benign inflation outlook. President Bush signed the *Jobs and Growth Tax Relief Reconciliation Act* into law this May. The provisions likely to have the biggest impact are nearly identical to those of the initial proposal. These are the acceleration of scheduled rate cuts, the increased child tax credit, and some relief from the alternative minimum tax and marriage penalty. While the dividend and capital gains tax relief will have a limited impact on spending, the investment provisions should have some effect. The federal government also showed generosity to the states by providing $20 billion in relief to help bridge budget gaps.

After a couple of years of lackluster growth, the economy should strengthen over the forecast period. After growing just 2.4% in 2003, real GDP should increase 4.3% in 2004, and 3.3% in 2005 and 2006.

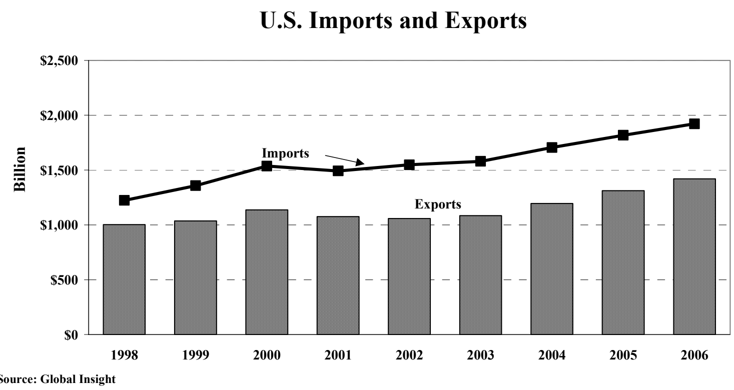
SELECTED NATIONAL ECONOMIC INDICATORS



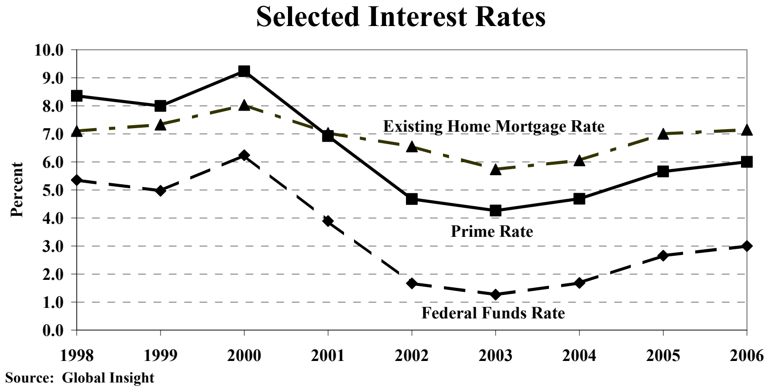
Consumer Spending: Americans continue to shop, but they are not spending as freely as they once did. After growing at a healthy pace during the first three quarters of 2002, real consumer spending slowed considerably in the last year's fourth quarter and has languished in the first half of this year. Part of this slowing reflects the recent three-quarter decline in inflation-adjusted spending for durable goods. Falling automobile sales are largely to blame for this swing. In the third quarter of 2002 real sales of new automobiles advanced by an amazing 32.9% annual rate, but plunged nearly 40.0% in the following quarter. One reason for this reversal is durable goods are purchased infrequently. Once the demand for a durable good, such as an automobile, is met it will be awhile before it is purchased again. Thus, even the most tempting financing programs cannot continually lure shoppers into automobile showrooms. As a result, real spending on durable goods should have less impact on overall spending than it did in the recent past. Specifically, real durable goods spending advanced faster than overall spending in 2002, 7.3% versus 3.1%. But total consumer spending and durable goods spending should both rise 2.4% this year. Next year, durable spending should grow slightly faster than total spending thanks to the bump in disposable income resulting from the 2003 Tax Act. The exact impact of the Tax Act will be determined by how consumers treat their windfalls. The hope is consumers will spend this found money instead of saving it or paying down debt. A case can be made that consumers will spend because consumer confidence is relatively high and there appears to be no limit to consumers' spending appetites. However, the impact will be smaller if consumers view the income increase as temporary and choose to save it or use it to pare down debt. This forecast assumes the increased disposable income will boost consumer spending \$23 billion in the third quarter of this year and \$40 billion in the fourth quarter. In 2004, the tax cuts will translate into a \$130 billion boost to consumer spending. The peak impact on spending should come in 2005, when the income tax cuts stimulate an additional \$160 billion in consumer purchases. Overall, real consumer spending is expected to rise 2.4% this year, 3.8% next year, and 3.0% in both 2005 and 2006.



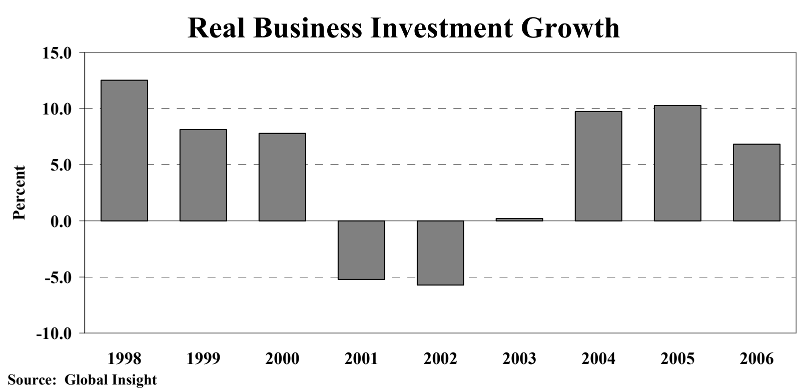
Inflation: Prices changes are becoming worrisome again. However, they are not the typical concerns. This generation has lived through an era that economists have named the "Great Inflation." This period from the mid-1960s to the early 1980s was marked by steadily rising prices interrupted by a few episodes of runaway inflation. Policy makers are now wrestling with the prospect of deflation. The last time the U.S. economy experienced an extended period of falling prices was the Great Depression. But one does not have to go that far back to find an example of deflation and its devastating impacts. Since the early 1990s the Japanese economy has been crippled by falling prices. Unfortunately, Germany may also be on the cusp of a deflationary cycle. While it is too early to declare whether this is the start of a trend, both the producer price and consumer price indexes dropped in April 2003. (Admittedly, portions of these declines had to do with falling energy prices that resulted from retreating oil prices due the success of the Iraq War.) Despite April's inflation data, there are at least four strong arguments suggest the U.S. is not entering an extended period of falling prices. First, the jolt from falling oil prices has already been felt. Indeed, evidence suggest energy prices have stabilized and may show a slight bump. Also, rising natural gas and coal prices will push up energy prices, which run counter to deflation. Second, the slow rise in commodity prices recently is a result of constrained production. But with GDP growth expected in the second half of this year, demand will improve, allowing for higher costs to be passed on to customers. This will be enhanced by the weaker dollar, which also provides U.S. businesses with room to raise domestic prices. Third, growth in employee compensation is a major factor in core inflation. Compensation is expected to grow slowly over the forecast period. Specifically, total compensation (earnings and benefits) should advance 3.7% this year, 3.4% next year, 3.6% in 2005, and 3.5% in 2006. Fourth, the collapse of Japanese real estate prices was a major contributor to that country's economic woes. This is not likely to be repeated in the U.S. because housing prices are not expected to collapse. Over the forecast period consumer prices are anticipated to increase 2.2% in 2003, 1.5% in 2004, 2.2% in 2005, and 2.4% in 2006. Producer prices for final goods should rise 3.4% in 2003, 0.6% in 2004, 1.1% in 2005, and 1.4% in 2006.



International: The U.S. dollar has been pummeled since early 2002. In fact, since this January alone the dollar has tumbled 10% against the euro, 14% against the Canadian dollar, and 2% against the yen. These declines are symptomatic of foreigners ebbing confidence in the U.S. economy. There are several factors that have led to this situation. First is the chain of U.S. corporate accounting scandals. The second factor is the failure of the U.S. economy to post a strong recovery. Third, the dollar may be the victim of the international fallout from the unpopular war with Iraq. Fourth, international wariness regarding the ballooning U.S. current account deficit is also holding the dollar down. Interestingly, the U.S. has done little to bolster the dollar. The nation's official policy calls for a strong dollar, but the Bush administration has done little to boost the dollar and Federal Reserve's rate cuts have put downward pressure on the dollar. This is not to say that a weak dollar is all bad. As conveyed in a statement that Treasury Secretary Snow no doubt regrets making, a weaker dollar helps exports. This is because the cheaper dollar makes American goods and services relatively less expensive in the global market. This could provide a much-needed shot in the arm to American businesses that have been struggling in international markets. A couple of risks usually associated with a falling dollar do not appear to be pressing. A falling dollar can contribute to inflation because it raises the price of imported goods and provides opportunities for domestic companies to raise their prices. However, an assessment of the current and near future inflation suggests this is not threat. The other concern is that foreigners will resist holding assets that are valued in dollars because a further erosion of the greenback will undermine the value of these assets. This could have a dampening effect on the nation's stock and financial markets. As in the case with inflation, this does not seem to be a problem in the short term. This forecast assumes the dollar's steepest declines are over. The dollar is expected to fall further, but much more gradually than it did from 2002 to 2003. As expected, the major beneficiary from this decline should be exports. After seeing its share contract below 8.5% of GDP, goods exports' share is anticipated to expand above 9.0% by 2006. Real net exports should be -$495.4 billion in 2003, -$510.0 billion in 2004, -$505.5 billion in 2005, and -$500.6 billion in 2006.



Financial: The nation's central bank recently lowered its bellwether federal funds rate by 25 basis points to 1.0%. This move is just the latest in the Federal Reserve's long battle to assist economic growth. While the economy has been moving forward, its pace has been disappointing. Since the beginning of 2001, the Federal Reserve has lowered the federal funds rate by 525 basis points. It has been able to take this aggressive action because inflation has been benign. In fact, in recent months concerns have shifted toward deflation. While a drop in prices may seem initially attractive, they can play havoc with the economy. For example, it can cripple consumer spending and investment. Consumer spending is affected because if prices are falling it is to consumers' advantage to postpone making purchases, especially for big-ticket items. The same holds for business investment. In addition, businesses will be reluctant to invest in machinery and buildings that will quickly lose value. The Federal Reserve clearly hopes to avoid the deflationary cycle that has crippled the Japanese economy for over a decade. One of the challenges facing the Federal Reserve is it is beginning to run out of room to maneuver because the federal funds rate cannot go below zero. Japan has already run into this problem. Its short-term interest rate is virtually zero, yet Japan's economy remains mired in recession. Consistent with the assumption the U.S. economy should rebound in the second half of this year, this forecast assumes the Federal Reserve will gradually raise interest rates beginning in the last quarter of this year. On an annual basis, the federal funds rate is expected to average 1.27% this year, 1.68% next year, 2.66% in 2005 and 3.00% in 2006.

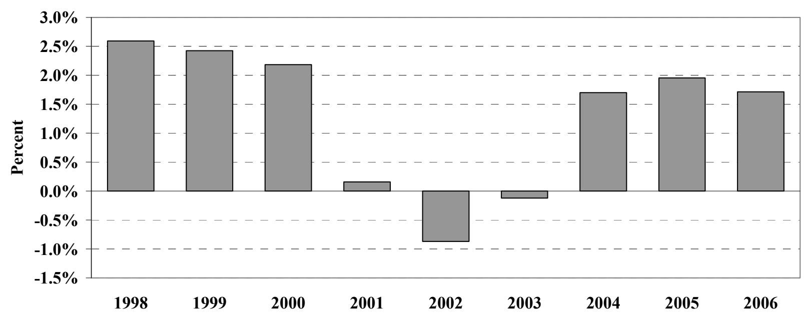


Business Investment: Business investment has been hurt by a series of unfortunate events including excess capacity, accounting scandals, the oil spike, and the uncertainty surrounding the war with Iraq. Given the low interest rates, the completion of the war, oil prices settling down, and the fiscal stimulus in the pipeline, it appears conditions are ripe for a business recovery. One of the most disappointing features of this recovery is the downturn in equipment and software spending. Until recently this sector was a dependable source of growth. But currently, it is suffering its most drawn out downturn among the 12 postwar recessions. However, it should begin showing signs of life again during the second half of this year, and be in full recovery in 2004. Specifically, after suffering a 6.3% annualized decline in the first quarter of this year, real spending on equipment and software is projected to expand at a 10.0% annual rate by the end of 2003. As a result, this category should manage 2.9% growth this year, which is an improvement over the 1.7% decline in suffered in 2002. After this year, real investment in equipment and software should accelerate to an 11.2% clip in 2004. The outlook for investment in nonresidential structures is not as bright. In fact, investment in structures is expected to decline over the next two years. Total business investment is forecast to grow 0.2% in 2003, 9.8% in 2004, 10.3% in 2005, and 6.8% in 2006.

Government: President Bush signed the *Jobs and Growth Tax Relief Reconciliation Act* into law on May 28, 2003. This bill is a scaled back version of what the President proposed earlier this year. The provisions likely to have the biggest impact are nearly identical to those of the initial proposal. These are the acceleration of scheduled rate cuts, the increased child tax credit, and some relief from the alternative minimum tax and marriage penalty. Congress cut back on the dividend tax relief, but added some capital gains and investment benefits. While the dividend and capital gains tax relief will have a limited impact on spending, the investment provisions should have some effect. Unfortunately, not all of the reductions to personal taxes will translate into stimulus. Much of the benefit from the cut in dividends and capital gains taxes may not be realized until the 2004 the filing season, at which time a large portion may be reinvested rather than spent. Even so, the entire tax package should add nearly one-percentage point to real GDP growth over the next year. Contributing to this projection is the withholding reduction this summer and the $400 child credit checks. It should also be noted that most provisions are backdated to the beginning of this year, so unless individuals adjust their withholding, refunds will be up in the first quarter of 2004, giving spending another boost at that time. The federal government also showed generosity to the states by providing $20 billion in relief to help bridge budget gaps. (Idaho's share of this package was $85 million.) With the 2003 tax bill out of the way, Congress is turning its attention to a Medicare prescription drug benefit. Although the drug benefit will theoretically be accompanied by cost –saving reforms, it is unlikely they will make a serious dent in the growth of Medicare. Thus, between the tax cut and expanded Medicare, Congress is contemplating adding more than three quarters of a trillion dollars over the next decade.

Employment: Midway through 2003, the nation's employment picture has yet to show signs of improvement. In June of this year, the U.S. unemployment rate jumped to its highest level in nine years. Most economists believed this important indicator of the labor markets vitality would peak near 6.0%, but were surprised when it hit 6.4%. The U.S. Department of Labor reported another couple of disturbing facts in its June 2002 *Employment Situation Summary*. First, people are staying unemployed longer. The number of persons that have been looking for work longer than 27 weeks has increased 410,000 over the year. They represented 21.4% of the total unemployed, which was up from 18.8% the previous year. Second, the economy continues shedding manufacturing jobs. In June alone 56,000 jobs were lost. The U.S. Department of Labor reports that more than 2.6 million manufacturing jobs have vanished since its most recent peak in July 2000. Not all the labor news was bad, however. Construction employment showed strength this June and health care services expanded by 33,000 jobs. Although the 6.4% unemployment rate was disappointing, it should be kept in perspective. First, it is still well below than 7.8% peak of the 1990-91 recession. Second, even though it was higher than expected, economists were expecting the peak sometime in midyear. If June's 6.4% is the peak, then economists would have timed it accurately. Given the data, it would be premature to redo the employment forecast. Indeed, a major contributor to the anticipated recovery has not changed. This is the 2003 Tax Act that was recently signed into law. The Tax Act will stimulate both consumption and business investment by raising personal disposable income and providing attractive incentives for business depreciation and expensing. The service sector should be the main beneficiary of these changes. Unfortunately, the Tax Act is not expected to stem the hemorrhage of manufacturing jobs. The combination of productivity gains and foreign competition should continue to weigh heavily on the manufacturing sector and contribute to expected manufacturing job losses of 570,000 jobs in 2003 and 300,000 in 2004. A turning point occurs in 2005, when the manufacturing sector picks up 240,000 jobs.

U.S. Nonfarm Employment Growth



Source: Global Insight

This improvement results from the weak dollar, stronger corporate profits, and rising domestic demand. Unfortunately, this recovery will be short lived, and this sector's job growth is forecast to flatten in 2006. After shrinking 0.1% in 2003, U.S. nonfarm employment is projected to increase 1.7% in 2004, 2.0% in 2005, and 1.7% in 2006. The civilian unemployment rate is expected improve slowly over the forecast period, averaging 6.0% this year, 5.8% next year, 5.6% in 2005, and 5.5% in 2006.